

ST 96-42

Tax Type: SALES TAX

Issue: Responsible Corp. Officer - Failure to File or Pay Tax

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

| | |
|--------------------------|----------------------------|
| DEPARTMENT OF REVENUE |) |
| STATE OF ILLINOIS |) |
| |) |
| v. |) NPL |
| |) |
| TAXPAYER, as responsible |) Mimi Brin |
| officer of CORPORATION |) Administrative Law Judge |

RECOMMENDATION FOR DISPOSITION

Appearances: Messrs. Elias Matsakis and Christopher Grant of McBride, Baker & Coles for TAXPAYER; Special Assistants Attorney General Alan Osheff and Marc Muchin for the Illinois Department of Revenue

Synopsis:

This matter comes on for hearing pursuant to Mr. TAXPAYER's (hereinafter referred to as "TAXPAYER") protest of Notice of Penalty Liability No. XXXX (hereinafter referred to as the "NPL") issued by the Illinois Department of Revenue (hereinafter referred to as the "Department") against TAXPAYER as an officer of CORPORATION (hereinafter referred to as the "Corporation" or "CORPORATION"). The NPL represents a penalty liability for Retailers' Occupation Tax and related taxes admitted by the corporation as due to the Department for the periods of July, August and September, 1991¹ (hereinafter referred to as the "Liability Period") but were unpaid.

¹. At the hearing, the Department advised that it was not seeking penalty liability against TAXPAYER for the months of November and December, 1991 as shown on the NPL. 7/20 Tr. pp. 17-18

A hearing in this matter was held on July 20 and July 21, 1995.² Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Notice of Penalty Liability No. XXXX, with the deletion from the Notice of the following assessments: XXXXX, for the month of December, 1991, with a tax amount of \$9,931, and XXXXX for the month of November, 1991, with a tax amount of \$9,931. Dept. Ex. No. 1; 7/20 Tr. pp. 17-18

2. TAXPAYER was the president, chief executive officer and the shareholder of 100% of the shares of TAXPAYER Acquisition, which was the corporate owner of CORPORATION Corporation from February 15, 1988. 7/20 Tr. pp. 62, 92, 94, 134

3. In 1991, CORPORATION was a printing company. 7/20 Tr. p. 137

4. TAXPAYER was the president of CORPORATION during July, 1991 through December 17, 1991. 7/21 Tr. pp. 28, 84; Taxpayer Ex. No. 3

5. TAXPAYER Acquisition purchased CORPORATION from BUSINESS, a Cleveland business. 7/20 Tr. p. 133; 7/21 Tr. p. 8

6. Corporation checks required two signatures for issuance, although some checks were pre-signed and some checks went out without two signatures. 7/20 Tr. pp. 63-64, 65, 125, 196

7. TAXPAYER was one of the authorized signatures on corporation checks. CONTROLLER, the controller of CORPORATION (hereinafter referred to as "CONTROLLER")³ was the other authorized signature. 7/20 Tr. pp. 63, 125, 196

². For purposes of this recommendation, references to the hearing transcript of July 20 are cited as "7/20 Tr." with the July 21 hearing cited as "7/21 Tr.".

³. Mr. CONTROLLER, although subpoenaed by the Department to testify at the hearing, failed to appear. On June 22, 1995, CONTROLLER was the deponent at an evidence deposition with both parties herein present. His testimony, offered at hearing, results from a direct reading into the record of his deposition testimony.

8. TAXPAYER became aware, on or about December 9, 1991, that the corporation's July, August and September Retailers' Occupation Tax returns were not timely prepared or filed. 7/20 Tr. p. 68

9. During July, 1991 through October, 1991, the corporation paid its payroll tax obligations. 7/20 Tr. p. 95

10. During the period of July, 1991 through October, 1991, CORPORATION was seeking refinancing. 7/20 Tr. p. 94

11. For the period of July, 1991 through October, 1991, BANK was the corporation's senior lender and was financing it's receivables on a daily basis. 7/20 Tr. p. 96; 7/21 Tr. p. 8

12. CORPORATION's eligibility for funds from BANK was dependent upon collateral reports based on receivables and inventory. 7/21 Tr. p. 10

13. During that period of time, BANK questioned the accuracy of the corporation's collateral reports, requesting independent verification of its inventory collateral. 7/21 Tr. pp. 11, 17 Based on this and in connection with the refinancing of CORPORATION, as well as for the purpose of completing the 1990 company audit, the business was being audited by BANK. 7/20 Tr. pp. 98, 99; 7/21 Tr. p. 17

14. TAXPAYER retained, through the insistence of BANK, the certified public accounting firm of Arthur Andersen to assist the corporation for purposes of the audit, that is, to reconcile the corporation's inventory records and to complete its 1990 audit. 7/20 Tr. pp. 98, 111-112; 7/21 Tr. p. 17

15. During 1989 and 1990, CORPORATION filed some ROT returns which showed that no tax was due to Illinois. 7/20 Tr. p. 104-105; Taxpayer Ex. 2 TAXPAYER was not required, personally, to take any action on these returns, which were filed by CONTROLLER. 7/20 Tr. pp. 105, 123

16. CONTROLLER was the corporation's controller from February, 1985 through December 13, 1991. 7/20 Tr. p. 133;

17. CONTROLLER's responsibilities were, *inter alia*, to prepare financial statements, to prepare daily collateral reports for BANK for the purpose of

monitoring compliance with financial agreements between the corporation and the bank, to run the corporation's computer, to prepare accounts payable checks at TAXPAYER's direction, to fill out and sign the ROT returns and to hand deliver the returns with payment to a Department office following TAXPAYER's additional signature on the payment check. 7/20 Tr. pp. 124-125, 135, 188; 7/21 Tr. pp. 13-14

18. For the period of July, 1991 until about December 13, 1991, CONTROLLER prepared, had the appropriate checks made out and signed and filed Illinois payroll tax returns for CORPORATION. 7/20 Tr. pp. 173-74

19. For that period, CONTROLLER also "cost" jobs for CORPORATION to determine whether they were profitable. 7/20 Tr. p. 178; 7/21 Tr. p. 12

20. For that period of time, CONTROLLER was responsible for the preparation of the collateral reports for BANK. 7/21 Tr. p. 11

21. From July, 1991 through December, 1991, the corporation was in default on its loan agreements with BANK and was behind in its payments to its vendors. 7/20 Tr. p. 181; 7/21 Tr. p. 164

22. CONTROLLER, as a result of his efforts to respond to vendors' inquiries and payment demands, and his efforts in providing information on a constant and regular basis to the bank, auditors and accountants who were present on the premises or were demanding books and records, etc. on a frequent basis, fell behind during the period of July, 1991 through December 13, 1991 in his cost reports and in preparing the Illinois ROT returns. 7/20 Tr. pp. 183-87; 7/21 Tr. pp. 14-15, 163-64

23. From July, 1991 through November 30, 1991, the corporation made sales on which sales tax was charged to the customer and on which receipts were received and deposited into an account at BANK. 7/21 Tr. pp. 189-90

24. TAXPAYER spoke to CONTROLLER on a daily basis from July, 1991 until CONTROLLER resigned in December, 1991. 7/21 Tr. pp. 87-88

25. CONTROLLER did not present to TAXPAYER, until December 9, 1991, any ROT returns or corresponding checks for the liability periods of July, August and September, 1991. 7/20 Tr. pp. 67-68, 203; 7/21 Tr. pp. 90-91, 170

26. Payments for those ROT returns were prepared by CONTROLLER, were presented to TAXPAYER and were sourced to bank funds available on the corporation's payroll account at a bank other than BANK. 7/20 Tr. p. 203; 7/21 Tr. pp. 170-71, 173-77, 185-86, 195-96 Those returns and checks were dated December 9, 1991, and were made out to the Illinois Department of Revenue and were for payment of ROT liability for July, August and September, 1991. Dept. Ex. Nos. 8, 9, 10, 11; 7/21 Tr. pp. 97-109

27. TAXPAYER did not sign the checks accompanying these late returns in the presence of CONTROLLER on December 9, 1991, therefore, CONTROLLER did not take them to the bank for certification of funds and did not deliver them to the Department. 7/21 Tr. pp. 177-79, 192

28. In 1991, TAXPAYER did not have available to him any audited corporation financial records, but, rather, had available only the unaudited records that CONTROLLER prepared as controller. 7/20 Tr. p. 188; 7/21 Tr. pp. 168-69 During this time, up through at least December 9, TAXPAYER had available, upon his request, computer print outs of the corporation's accounts receivables. 7/21 Tr. pp. 93-94

29. TAXPAYER was responsible for 80 percent of the sales for CORPORATION. 7/20 Tr. p. 189

30. During July, 1991 through December, 1991, TAXPAYER dealt with concerned vendors regarding corporation payments for supplies. 7/20 Tr. p. 189

31. During that period of time, TAXPAYER was actively seeking refinancing for CORPORATION. 7/20 Tr. pp. 94, 189; 7/21 Tr. pp. 11-12

32. During July, 1991 through December, 1991, vendors were being paid by the corporation. 7/20 Tr. p. 196

33. BANK did not renew its loan agreement with CORPORATION as of December 9, 1991, and the corporation no longer had any BANK funds in its control subsequent to that date. 7/21 Tr. pp. 23-25

34. On or about December 9, 1991, TAXPAYER advised BANK's agent for the liquidation of the corporation, Morris Andersen and Associates, of bills which were outstanding, including sales tax liability. 7/21 Tr. pp. 25-27, 30, 87

35. TAXPAYER executed a turnover agreement with BANK for the liquidation of CORPORATION on December 17, 1991. 7/21 Tr. pp. 30-31

36. CONTROLLER resigned from CORPORATION effective December 13, 1991. Although he was looking for another job from about July, 1991, CONTROLLER did not secure one until after Thanksgiving, 1991. 7/20 Tr. pp. 200-201

37. TAXPAYER resigned his offices with CORPORATION as of December 17, 1991. 7/21 Tr. pp. 28, 31; Taxpayer Ex. No. 3

38. The Department sent a letter to CONTROLLER regarding his involvement with the corporation for the period of July, 1991 through December, 1991, pursuant to which CONTROLLER supplied the Department with an affidavit, following which, CONTROLLER believed the Department exonerated him from any personal liability for the liabilities of CORPORATION. 7/20 Tr. pp. 192-93

39. TAXPAYER received notices from the Department in 1992 wherein the Department advised that it had not received payment with corporation ROT returns for the months of July, August and September, 1991 and further advised TAXPAYER of a balance due for those months. Dept. Ex. Nos. 2, 4, 5

40. TAXPAYER responded to these notices by sending the Department those corporation ROT returns for the months of July, August and September, 1991 as they were prepared by CONTROLLER and shown to TAXPAYER on or about December 9, 1991. Dept. Ex. Nos. 3, 6, 11, 7/21 Tr. pp. 109-111

41. TAXPAYER did not advise the Department that the returns he submitted for the liability period were incorrect at the time the Department advised him, pursuant to several notices, that there remained unpaid balances for the business for the liability period. Dept. Ex. Nos. 3, 6; 7/21 Tr. pp. 109-111

Conclusions of Law:

The penalty at issue herein is based upon the Retailers' Occupation Tax liability of CORPORATION for the periods of July, August and September 1991. The corporation untimely submitted to the Department the required tax returns without payments for the amounts stated therein.

During the liability period, TAXPAYER was the sole shareholder and president of TAXPAYER Acquisition, the entity which owned CORPORATION. Thus, he was the owner of this corporation. During this period, he was very actively involved in corporate activities, i.e. he spent 80% of his time as the corporation's salesperson, he dealt with vendors and customers and he was deeply involved with corporate finances. In addition, he was one of two signatories necessary to negotiate corporate checks.

The other corporation signatory during the liability period was CONTROLLER, the corporation's controller who was with CORPORATION from February, 1985 until his resignation in December, 1991. CONTROLLER had a great many responsibilities as controller, including that of preparing the ROT returns, signing them, preparing and signing the appropriate corresponding checks, having TAXPAYER also sign the checks and forwarding the returns and checks to the Department. TAXPAYER conferred responsibilities onto CONTROLLER and there is no evidence of record, which indicates that it was unreasonable for TAXPAYER to do so and to assume that CONTROLLER was doing what he was required to do.

The normal business climate changed for CORPORATION in 1991. TAXPAYER, a finance specialist by trade, highly leveraged the purchase of the corporation. The corporation's indebtedness was to BANK and to another company, for whom TAXPAYER worked prior to obtaining CORPORATION. By July, 1991, the corp's 1990 audit was not done and the corporation was in default on its loans to BANK. In turn, BANK demanded that the 1990 audit be completed, and BANK, its agent AGENT, and the accounting firm of Arthur Anderson were at CORPORATION, demanding and using its books and records.

It was also from July, 1991, that TAXPAYER was actively seeking refinancing for the failing company. At this time, CONTROLLER's responsibilities increased and included being at the constant call of the bank and outside accounting personnel, as well as addressing the demands of vendors regarding payments.

It is at this point that the testimony offered by the witnesses conflicts. TAXPAYER testified that although he spoke to CONTROLLER on a daily basis during the liability period, he was not advised that CONTROLLER was not timely preparing and filing the ROT returns. CONTROLLER, during his evidence deposition, averred that he advised TAXPAYER that he was not preparing and filing the required returns.

For purposes of this hearing, I find that it is not unreasonable to believe that although TAXPAYER and CONTROLLER spoke daily, CONTROLLER was not advising TAXPAYER that he was not timely filing ROT returns. First, both testified that the liability period was a difficult time for both TAXPAYER and CONTROLLER. Their skills and attention were spread very thin, requiring lengthy, tension filled hours, with TAXPAYER attempting to continue to elicit clients for the business as well as dealing with upset vendors and expending a great deal of time and energy in trying to obtain financing for the failing business.

Likewise, CONTROLLER was on constant call from the bank, its agent and the accounting firm, all of whom were questioning him and demanding records from him. He was dealing with vendors' complaints and demands for funds. These duties were in addition to his already full schedule of daily records keeping and job costing as well as his activities in finding other employment.

In addition, CONTROLLER's credibility was clearly impeached at hearing. First, although subpoenaed to testify, he failed to appear and offered no notice or excuse. More importantly, however, at his evidence deposition, he initially testified, as well as advised the Department in a written statement, that he resigned his controller's position in August, 1991, when, in fact, as he later admitted, he held the controller's position until his resignation on December 13, 1991. Obviously, a resignation in August, 1991 would assist in removing

CONTROLLER from a position of control and authority within the corporation for the purposes of personal liability for the corporation's failure to pay its ROT liability for the liability period, as the July return was due at the end of August, 1991. His sworn testimony that he resigned in August is blatantly self-serving and a falsehood.

Additionally, I find TAXPAYER's testimony not unreasonable whereby he testified that CONTROLLER's failure to present him with a monthly check for the corporation's ROT liability would not necessarily have raised a red flag. CONTROLLER prepared and signed the ROT returns. It is not unreasonable for TAXPAYER to have relied on CONTROLLER to do this given CONTROLLER's years with the business and the lack of a history of problems with the Department in this area. It is also quite plausible that with all of the other emergencies and financial pressures each day during these difficult times, that TAXPAYER would not have noted that a particular check was not presented to him for signature. This is especially true if there were, historically, months in which no ROT monies were due because of credits, etc. as both TAXPAYER and CONTROLLER testified.

However, on or about December 9, 1991, TAXPAYER, through his own admission, was notified by CONTROLLER that ROT returns had not been filed for the liability period and that monies were due on those returns. It was on this date that TAXPAYER's actions or inactions become critical to the analysis of whether he is liable for Section 13½ penalty.⁴

On or about December 9, 1991, TAXPAYER was not only advised that ROT returns were outstanding and needed to be filed, but, was further informed that the funds to cover the liability were still available to CORPORATION in spite of the fact that BANK had stopped all other corporation funding. TAXPAYER knew at that time that sufficient monies were available in the corporation payroll

⁴. The liability against TAXPAYER accrued in 1991, when the taxes at issue became due and owing. Therefore, the statute which applies is Ill. Rev. Stat. 1991, ch. 120, par. 452½ and not 35 ILCS 735/3-7 which provides for a personal liability penalty effective January 1, 1994. Sweis v. Sweet, 269 Ill. App.3d 1 (1st Dist. 1995)

account at another bank. Rather than direct CONTROLLER to use those funds for the tax liabilities, he submitted the returns to BANK's agent with the information that these CORPORATION liabilities, along with others, were outstanding. Shortly thereafter, TAXPAYER resigned from CORPORATION and left the company.

If at no point sooner, it was on December 9 that TAXPAYER made the decision not to use available business funds to pay the corporation's ROT liabilities. Essentially, then, TAXPAYER made the choice to prefer other corporate obligations to the State of Illinois. It is this action that triggers TAXPAYER's personal liability for the ROT taxes at issue.

During the liability period, there was in effect within the Retailers' Occupation Tax Act the following provision:

Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed in accordance with Section 3 of this Act and who wilfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon; The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section. Proof of such determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. Such reproduced copy shall, without further proof, be admitted into evidence before the Department or any legal proceeding and shall be prima facie proof of the correctness of the penalty due, as shown thereon.

Ill. Rev. Stat. 1991, ch. 120, par. 452½

This provision was most recently addressed by the Illinois Supreme Court, in Branson v. Department of Revenue, 168 Ill.2d 247 (1995).⁵ In its decision,

⁵. Branson holds that the Department presents a *prima facie* case for Section 13½ liability with the introduction into evidence of the NPL. Branson at 257-58 Pursuant to this authority, TAXPAYER's argument at hearing that the Department

the Court cited with favor Department of Revenue v. Heartland Investments, Inc., 106 Ill.2d 19 (1985), wherein the Supreme Court noted that the willful failure to pay the taxes at issue herein involved intentional, knowing and voluntary acts (*id* at 29-30) and held that a corporate officer wilfully failed to pay ROT liability pursuant to evidence that the taxes collected were knowingly used to pay corporate creditors other than the Department. See also, Department of Revenue v. Joseph Publick & Sons, Inc., 68 Ill.2d 568, 575-76 (1977)(in upholding personal liability, court discussed that corporate officers could use funds collected for State to pay, *inter alia*, salaries and bonuses to employees, thus making recovery of the funds from a defunct corporation impossible)

The Branson Court also recognized that because the term "willful failure" is undefined in the pertinent ROT provision, reference has been made to the interpretation of similar language in cases concerning the personal liability of corporate officers who wilfully fail to properly account for and pay over employees' social security and Federal income withholding taxes. Branson at 247

With Branson as the prevailing authority on the subject, I find that TAXPAYER is liable for a penalty equal to the amounts owed by the corporation for the liability period, for the reasons following. First, there is no disagreement that CORPORATION was subject to the provisions of the Retailers' Occupation Tax Act. There is also no question that TAXPAYER was an officer of the corp and had the ultimate control and responsibility for the filing of the returns and the remittance of the monies shown thereon to be due.⁶ See also Monday v. United States, 421 F.2d 1210, 1214-15 (7th Cir. 1970, cert. den. 400 U.S. 821 (1970)); Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979)

must present evidence of willfulness in its case in chief fails. See, *contra*, Griffith v. Department of Revenue, 266 Ill. App.3d 838 (1st Dist. 1994) As the Supreme Court had not decided Branson at the time of the administrative hearing, and with Griffith as conflicting authority at that time, I also note that this argument was not persuasive at hearing as the Department did not rely only on the NPL as its case-in-chief, but, rather, presented other evidence toward the issue of willfulness.

⁶. TAXPAYER was the only stockholder of TAXPAYER Acquisition which was the solely owned CORPORATION and he was president of CORPORATION. He held the power to hire, fire and direct the activities of the corporation's employees, including CONTROLLER. See 7/20 Tr. p. 71; 7/21 Tr. p. 71

(responsibility is a matter of status, duty and authority, not necessarily knowledge)

I also conclude that on December 9, TAXPAYER made the conscious decision to not use available funds to pay the Department what was represented at that time to be the corporation's ROT liability.⁷ Rather, he chose to pass his obligation to see that payment was made onto another without any assurances that the taxes would be paid. With established Illinois law as authority, this action is sufficient to sustain the imposition of a penalty liability on a corporate officer or employee.

Taxpayer attempted, at hearing, to introduce evidence as to CORPORATION's ROT liability for the liability period. The Department's objections to such evidence were sustained on the basis that this NPL hearing was not the correct forum for this issue. In my review of this record, I find that this determination was correct, based upon the specific facts of this case.

That is, TAXPAYER received the Department's correspondence, entitled "Notice of Assessment" (herein referred to as "Notice" or "Notices") regarding the corporation's liability for the liability periods. Dept. Ex. Nos. 2, 4, 5 These notices advised TAXPAYER that payment was owed to the State for those months and specifically requested contact if the representations on the notices were incorrect. *Id.* As part of his response to these notices, TAXPAYER submitted to the Department the very ROT returns CONTROLLER prepared, signed and gave to him on December 9, 1991.

⁷. One of taxpayer's positions at hearing was that TAXPAYER had a reasonable belief that no ROT was due for the liability period. 7/20 Tr. p. 38 However, the evidence of record is clear that on December 9, 1991, TAXPAYER was advised that returns had not been filed for the liability period and he was presented with the returns and with checks to satisfy the monies shown as due. By his own testimony, TAXPAYER directed these same returns to BANK's agent and advised that these returns represented bills which were outstanding. Therefore, on the date that is pertinent to these proceedings, it is not unreasonable to find that TAXPAYER believed that the monies represented on those returns were owed to the State. I note, in addition, that when TAXPAYER received notices from the Department that monies were owed on returns received without payment, he sent to the Department copies of those same returns filled out by CONTROLLER for the liability period without any changes to them. 7/21 Tr. pp. 60-71

Further, TAXPAYER supplied these to the Department without any corrections to them. Although TAXPAYER could have advised the Department that the recitation of liability set forth was incorrect, by sending in the returns prepared by CONTROLLER, unchanged, he made clear representations to the Department of the corporation's liability. By his actions, TAXPAYER admitted CORPORATION's liability for the periods at issue. This penalty liability is based upon either a final Department assessment or revised assessment, or, on the taxpayer's return filed with the Department. Sweis v. Sweet, *supra* By such admission, there are no statutory provisions whereby the Department need afford the corporate taxpayer any further rights to protest the admitted liability.⁸

Wherefore, for the reasons stated above, it is my recommendation that the Notice of Penalty Liability issued against TAXPAYER, as amended by the Department at hearing, be finalized.

8/23/96

Mimi Brin
Administrative Law Judge

⁸. This is not to say that the corporate taxpayer did not have remedies after TAXPAYER filed the ROT returns on its behalf. It could have filed amended returns (Form ST-1-X Amended Sales and Use Tax Return). 35 ILCS 120/6 The liability that appears on the NPL is the corporate liability pursuant to Department records as of the date of the NPL's issuance. The only issue at hearing is the personal liability of the officer or employee. Once liability is determined, the amount due is the amount of corporate liability after application of payments made and/or after application of amounts pursuant to properly filed amended returns. I take administrative notice of the fact that the Department has applied credits to CORPORATION's liability and the actual amounts due from the corporation and, thus, from TAXPAYER are considerably less than the amounts represented on the NPL.